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Proposal for a Federal Reinsurance Program for State FAIR Plans

I. Proposal: Federal Reinsurance Program for State FAIR Plans

The federal government could establish a federal reinsurance program for state FAIR Plans, in order to reduce the cost associated with purchasing private reinsurance for state FAIR Plans, which in turn would help reduce the cost of FAIR Plan insurance, and to enable FAIR Plans to obtain access to more reinsurance to reduce the likelihood that they would have to assess private insurers in the event FAIR Plan claims exceed reserves, which in turn is contributing to private insurers reducing or declining to write insurance. A federal program of reinsurance, which does not seek to make profits and whose reserves are funded by US taxpayers, would be able to offer reinsurance at a lower premium price than private reinsurers and be able to offer better terms such as lower attachment points and more coverage than private reinsurers are willing to take on.

This narrow federal reinsurance program for FAIR Plans, as opposed to a broader federal reinsurance program for all private property and casualty insurers, would also cost taxpayers substantially less, avoid a large taxpayer subsidy for private insurers, and avoid masking the climate change price signal that private insurance pricing and availability is currently sending with regard to the sustainability of development in areas at high risk of loss due to climate change.

II. Background and Rationale for Federal Reinsurance Program for FAIR Plans

Due to more frequent and severe weather-related events driven by climate change, private home insurance is becoming increasingly unaffordable and unavailable in more areas of the United States. A recent *New York Times* report found that homeowners in 18 states are facing increased premium costs and insurers declining to renew or write new insurance, as insurers respond to increased losses due to climate change.[1] We are marching toward an uninsurable future due to the

[1] "As Insurers Around the U.S. Bleed Cash from Climate Shocks, Homeowners Lose," May 14, 2024, *The New York Times*. https://www.nytimes.com/interactive/2024/05/13/climate/insurance-homes-climate-change-weather.html.

failure to move fast enough to transition from fossil fuels and otherwise reduce greenhouse gas emissions.

As homeowners are unable to find insurance from traditional "admitted" private insurance companies, they are forced to buy insurance from the less regulated and more expensive non-admitted "surplus lines insurers"[2] or from insurance "residual markets" established by state law as insurers of last resort.

Thirty-three states and the District of Columbia have established "residual markets" to write insurance for risks which private admitted carriers are not writing. In most of these states legislation establishes a Fair Access to Insurance Requirements (FAIR) Plan which is an involuntary association of admitted property and casualty insurers.[3] FAIR Plans are usually structured so that if there is a shortfall in reserves or excess reserves, the insurance company members of the association share in making up the shortfall through an assessment based on their relative market share or share in payouts of excess reserves. Florida and Louisiana are notable exceptions, where both states enacted laws where all policyholders in the state are assessed by either Florida Citizens Property Insurance Company or Louisiana Citizens Property Insurance Company, respectively, in the event reserves are insufficient to pay claims.

As private admitted insurers decline to renew or write insurance, the number of FAIR Plan policyholders is increasing. FAIR Plans turn to the private reinsurance market to cover some portion of their insured risks and liabilities. Reinsurers have been raising rates in the face of climate change, which in turn raises costs for FAIR Plans and requires that they raise premium prices for FAIR Plan policyholders. FAIR Plans are not subsidized by state taxpayers. As they are covering homeowners and businesses with the highest risk, premium prices generally are higher than the private market. Increasing numbers of homeowners unable to find private insurance and unable to afford FAIR Plan insurance are going without home insurance.

As FAIR Plan policy counts will continue to grow, there is growing risk that major catastrophic events could result in losses for a FAIR Plan that exceed its reserves, in which case the FAIR Plan in most states would assess private insurers in the market based on their relative market share. The possibility of a FAIR Plan assessment can cause insurers to reduce renewals or pause or stop writing new insurance, as is the case now in California.

To help offset the cost of private reinsurance for state FAIR Plans and to enable FAIR Plans to obtain access to more reinsurance to reduce the likelihood that they would have to assess private insurers which in turn is causing insurers to reduce or stop writing insurance, Congress could

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[2] The surplus lines market makes up 11% of the overall property and casualty market in the United States. *National Association of Insurance Commissioners* (*NAIC*). https://content.naic.org/cipr-topics/surplus-lines.

[3] "Insurance Supervision and Regulation of Climate Risks" Federal Insurance Office, US Department of Treasury. June 2023, p. 38. https://home.treasury.gov/system/files/311/FIO-June-2023-Insurance-Supervision-and-Regulation-of-Climate-Related-Risks.pdf. Since this report was written, Colorado enacted a FAIR Plan.

enact a federal reinsurance program for state FAIR Plans. A federal program of reinsurance, which does not seek to make profits and whose reserves are funded by US taxpayers, would be able to offer reinsurance at a lower price than private reinsurers and may be able to offer better terms such as lower attachment points and more coverage than private reinsurers are willing to take on. The lower cost federal reinsurance program would help FAIR Plans to offer prices lower than what they need to be now to account for private reinsurance costs.

A narrower federal reinsurance program for FAIR Plans also has the benefit of reducing much larger costs to federal taxpayers associated with a federal reinsurance program subsidizing all private property and casualty insurers and reduces the likelihood that federal reinsurance for private insurers will result in private insurers sending incorrect price signals about the growing risk of climate change. Targeting federal reinsurance to the insurers of last resort in states – FAIR Plans—shores up these insurers of last resort, assists their policyholders, and helps stabilize private insurance markets by reducing the likelihood of an assessment due to a shortfall in FAIR Plan reserves, without the risk of distorting private insurance markets and encouraging more development in new growth areas at high risk by subsidizing private insurers with federal reinsurance.

A federal reinsurance program for state FAIR Plans could also provide the opportunity to incentivize states to take additional actions to mitigate risk and loss. The provision of federal reinsurance for state FAIR Plans could be linked to a state taking actions which could include adopting improved building codes, adopting land use laws which disincentivize or limit new development in areas of high risk of loss due to climate related impacts, making investments in proven nature-based approaches to reduce risk and loss, requiring private insurers in the state to account for property, community and landscape scale mitigation in their underwriting and pricing, providing grants to homeowners to retrofit or harden their homes, and other state measures to reduce risk and loss.

A narrow federal reinsurance program for FAIR Plans, as opposed to a broader federal reinsurance program for all private property insurers in the United States, would cost taxpayers substantially less, avoid a large taxpayer funded federal reinsurance subsidy for private insurers, provide an opportunity to incentivize states to take actions to reduce risk and loss, and avoid masking the climate change price signal that private insurance pricing and availability is currently sending with regard to the sustainability of new growth development in areas at high risk of loss due to climate change which are outside of areas already entitled for development.